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IN THE SUPREME COURT
OF THE
UNITED STATES

OCTOBER TERM, 1982

CONTAINER CORPORATION OF AMERICA,
Appellant,
vs.
FRANCHISE TAX BOARD,
Appellee.

On Appeal from the Court of Appeal
of the State of California
for the First Appellate District

BRIEF OF AMICUS CURIAE STATES OF IDAHO AND UTAH

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STATEMENT OF INTEREST

The taxpayer in this case,

Container Corporation of America (hereinafter "CCA"), challenges the right of the State of California to use the combined reporting method of determining net income of a multi-jurisdictional corporation subject to California's franchise tax. The taxpayer contends, in part, that requiring a combined report of income violates the due process requirements of the Fourteenth Amendment to the U. S. Constitution.

The States of Idaho and Utah use--and have used for many years--combined reporting for groups of commonly owned corporations who conduct unitary business operations in interstate or international commerce. See e.g. ASARCO, Inc. v. Idaho State Tax Commission, ___ U.S. ___, 50 USLW

4962, Dk #80-2015 decided June 29, 1982. A growing number of states have recognized the validity of the unitary concept and are now applying the unitary method of reporting.

Combined reporting is a practical necessity in a nation and world where corporate activities and combinations know few, if any, economic boundaries. Without it, corporate taxpayers would be free to shift income among commonly controlled corporations dealing at less than arms length, thereby artificially reducing tax responsibilities to the states in which they do business. The only possible state response is to attempt to make transactional adjustments on a transaction by transaction basis to ensure they reflect a true arms length

relationship. Section 482 of the Internal Revenue Code allows the IRS to make such adjustments. However, federal experience amply demonstrates that the method is almost impossible to apply on the federal level. See, GAO Report to the Chairman of the House Committee on Ways and Means GGD-81-81, IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations (Sept. 30, 1981). Without a method of combined reporting, it would be totally impossible for states concerned about interstate as well as international commerce.

As an amicus curiae, the States of Idaho and Utah have a vital interest in protecting the authority of all states to use the combined reporting

method of attributing income for state tax purposes. We believe it to be fair, practical and constitutional.

SUMMARY OF ARGUMENT

A taxpayer who attacks a state income or franchise tax assessment under the Due Process Clause must show by clear and cogent evidence that (a) there is no minimal connection between the activities taxed and the taxing state or (b) that there is no rational relationship between the income attributed to the state and the intrastate values of the enterprise. CCA has not made that showing.

There is no question that CCA possesses the requisite nexus with California. The issue is whether the amount of income attributed to California is rationally related to

the amount of income-producing activity conducted there. When a group of commonly owned and controlled corporations conducts a functionally integrated business, application of the standard three factor formula to the combined apportionable income of the corporations automatically meets this second due process requirement.

When a group of corporations conducts a unitary business--such that the activities of each contribute to or are dependent upon the activities of one or more other corporations in the group--it is not reasonably possible to specifically or separately account for the income of each on a state by state basis. When a single corporation conducts such a unitary business, this Court has always

recognized that attributing income on the basis of the location of income-producing activities determined by the location of property, payroll and sales is reasonable and constitutional. See e.g., Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980). There is no constitutional or logical reason for this concept to apply differently if the same business activities are conducted by means of separately incorporated subsidiaries rather than by divisions of one parent. If, as this Court has held in Exxon, supra, a single unitary business conducted by one corporation can have its income attributed by apportionment formula without viclating the Due Process Clause, there is no due process bar to

apportioning the similar income of a unitary business conducted by a controlled group of corporations. The underlying income-producing activities--which are the justification for the apportionment in the first place--are unchanged by the creation of a legal fiction--i.e., subsidiary corporation.

ARGUMENT

State taxation of income generated by a business engaged in interstate or foreign commerce must meet two requirements to satisfy the due process clause of the Fourteenth Amendment. These requirements are that: (1) a "minimal connection" or nexus must exist between the interstate activities and the taxing state, and (2) there must be a

rational relationship between the income attributed to the state and the intrastate values of the enterprise. Mobil Oil Corp. v. Commissioner, 445 U.S. 425, 63 L.Ed.2d 510, 100 S.Ct. 1223 (1980); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 57 L.Ed.2d 197, 98 S.Ct. 2340 (1978).

A less formal statement of the test, but one which fully captures the substance of the questions involved, was set forth by this Court in Wisconsin v. J.C. Penney Co., 311 U.S. 435, 85 L.Ed. 267, 61 S.Ct. 246 (1940):

> That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.

This statement was made even more succinctly in Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 93 L.Ed. 585, 69 S.Ct. 432 (1948), reh.den. 336 U.S. 928, 93 L.Ed. 1089, 69 S.Ct. 653 (1949):

> So far as due process is concerned the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State.

The first prong of the Mobil test is clearly satisfied in this case. All that is necessary is that the business avail itself of the "substantial privilege of carrying on business within the State." Wisconsin v. J. C. Penney, supra. We do not understand CCA to question that nexus exists, which indeed it could not

contest in view of the fact that it has several manufacturing facilities located in California.

To succeed, CCA must show that the second prong of the test, the rational relationship test, is not met. It cannot succeed in this showing.

First, the fact that CCA conducts its operations in foreign countries through subsidiaries rather than as divisions provides no support for its argument. "The question is fundamentally one of whether a business should stand in a better position for purposes of determining income merely because it chooses to use a multiple corporation organizational scheme. We do not feel it should." Coca-Cola v. Department of Revenue (Oregon), 553 P.2d 778 (1975); Zale-Salem, Inc. v.

State Tax Commission (Oregon), 391 P.2d 601 (1964); Edison California Stores v. McColgan, 30 Cal.2d 472, 183 P.2d 16 (1947). As this Court said in Mobil Oil, supra, at 440-41 and 523:

> Superficially, intercorporate division might appear to be a more attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise. Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements for apportionability. Cf. General Motors Corp. v. Washington, 377 US 436, 441, 12 L Ed 2d 430, 84 S Ct 1564 (1964).

Second, the fact that foreign country operations are involved does not support CCA's due process

arguments in any manner. Bass, Ratcliff & Gretton Ltd. v. State Tax Commission, 266 U.S. 271, 69 L.Ed. 282, 45 S.Ct. 82 (1924); Mobil Oil Corp., supra.

CCA, to succeed, must answer a more basic question which has nothing to do with either the legal form chosen (subsidiary) or the nature of the forum (foreign) where its activities occur. CCA must show that the activities included in measuring the tax base before apportionment have no rational relationship to its activities in California.

It has long been established that:

> The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. (Wisconsin v. J.C.

> Penney, supra, at 445 and 271, and the cases cited therein.)

Furthermore, there is no requirement that a direct relationship be shown between the activity included in the tax base and the activity conducted within the state. "[T]he relevant constitutional test to establish the requisite nexus [is] . . . whether the facts demonstrate 'some definite link, some minimum connection . . .'" National Geographic Society v. California Board of Equalization, 430 U.S. 551, 51 L.Ed.2d 631, 97 S.Ct. 1386 (1977).

In establishing the rational relationship, the central concern of the inquiry should involve the activities within the state and how they relate to overall activities. As

pointed out by this Court in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 3 L.Ed.2d 421, 79 S.Ct. 357 (1959):

> The taxes imposed are levied only on that portion of the taxpayer's net income which arises from its activities within the taxing State. These activities form a sufficient "nexus between such a tax and transactions within a state for which the tax is an exaction."

The reason the test is concerned with the relationship between the in-state activities and the business as a whole is found in the measure of the tax.

> [I]n dealing with the rational relationship problem, we find the premise that a corporation in interstate/international business should pay a state for the governmental services and benefits provided by the state. (General Motors Corp. v. District of Columbia, 380

> U.S. 553, 14 L.Ed.2d 68, 85 S.Ct. 1156 (1965).)
>
> This notion is frequently expressed as requiring a relationship between the activities of the corporation and the net income attributed to the taxing state. However, the thrust of the notion has nothing to do with source of net income, if it is even possible to isolate net income. Its central concern is activity within the taxing state. (Richard G. Lathrop, "Due Process Consideration and the Apportionment of Dividend Income," Tax Notes, July 5, 1982.)

The test of due process has nothing to do with the source of income. Source determinations are inconsistent with the determination of net income. Net income is the result of determining gross income and subtracting from it deductions allowed by law. While in some instances it may be possible to isolate gross

income or receipts and assign them to a particular site, the same cannot be said for deductions such as interest and corporate overhead. These deductions are only assignable on a general basis and relate to the business operations as a whole. They eliminate any possibility of sourcing net income. They are the reason apportionment has become the rule. To attempt to argue that the source-of-income concept is meaningful to the rational-relationship concept "makes no economic sense and merely perpetuates separate accounting and specific allocation as alternatives to apportionment when in fact the gross income item involved has lost its gross income characteristic by the time it reaches the level of net

income to be apportioned among the taxing state." Ibid.

CCA may not successfully argue that the requirements of due process are violated because the activities of its subsidiaries in foreign countries are unrelated to its California activities. This argument has been advanced and rejected in a number of cases. Perhaps the best articulation for such rejection was provided by the Supreme Court of Maine in Albany International Corporation v. Halperin, 388 A.2d 902 (Maine, 1978), where it stated that to impart such a requirement that the tax was:

> . . . depend[ent] upon a showing of some connection between the local business and the production of particular income by one or more out-of-state elements of the business [would make the

> statute meaningless]. It could not have been the purpose of this legislation to create a system for rationalizing state income taxation of multistate or multinational business concerns, only to render it practically ineffective by requiring a showing that various items of out-of-state income, received in the regular course of business, were connected in some demonstrable way with activities of the taxpayer in Maine.

In a Florida case, Roger Dean Enterprises, Inc. v. State, 387 S.2d 358 at 362, the Court said:

> The taxpayer sub judice argues that to tax income from an out-of-state transaction by a foreign-chartered corporation amounts to a taking of its property without due process of law in violation of the Federal Constitution because there is no nexus between the transaction and the state of Florida. The requisite nexus is supplied when the corporation and some of its income producing activities are connected with the taxing

> jurisdiction. If this is the case, all of the corporation's income may be included in a fairly apportioned tax base for state income tax purposes. There is no requirement that each increment of income have a relationship to the taxing jurisdiction. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197 (1978); Northwestern States Portland Cement Co. v. State of Minnesota, 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959). [Emphasis added]

See also, Xerox v. Comptroller of Treasury (Maryland), 428 A.2d 1208 (1981); Gulf Oil Corp. v. Morrison, 120 Vt. 324, 141 A.2d 671 (1958); W.R. Grace & Co. v. Commissioner of Revenue (Massachusetts) 393 N.E.2d 330 (1979):

> Where there is apportionment by the standard three-factor formula, it is difficult to see how there [c]ould be any violation of due process because the formula itself normally will provide the rational relationship between the net income attributable

> to the state and the activities of the corporation in the taxing state. The rational relationship is not between the business activities of the corporation and specific items of gross income. If it were, we would be thrown back to the source syndrome and continue to chase our tails. (Lathrop, Tax Notes, supra)

The rational relationship is between the in-state and out-of-state activities, and the formula approach, by accounting for both, reflects this relationship.

As this Court stated in Mobil Oil Corp., supra, "the linchpin of apportionability in the field of state income taxation is the unitary business principle." Exxon Corp. v. Wisconsin, 447 U.S. 207, 65 L.Ed.2d 66, 100 S.Ct. 2109 (1980); F. W. Woolworth Co. v. Taxation and Revenue

Department, 50 Law Week 4957. As your Court quoted from the Idaho brief in ASARCO, Inc. v. Idaho State Tax Commission, 50 Law Week 4962:

> When income is earned from activities which are part of a unitary business conducted in several states, then the requirement that the income bear relation to the benefits and privileges conferred by the several states has been met.

Since the California courts have found that a unitary business exists, the requisite rational connection is shown. (It should be noted in passing that this is not the only way the connection can be shown. This language only indicates that once a unitary relationship is established the rational relationship is conclusively established.) As Justice Stevens pointed out in his dissent in

Mobil Corp., supra, at 462, the apportionable base and the formula must be considered together. It is the amount of the tax base apportioned to the state as compared to the activities in the state which is the critical test for due process consideration. As stated in Ott v. Mississippi Valley Barge Line Co., supra:

> Those requirements are satisfied if the tax is fairly apportioned to the commerce carried on within the State.

CONCLUSION

The states' use of the unitary method satisfies the requirements of the due process clause. As this Court said in Wisconsin v. J. C. Penney, supra:

> A state is free to pursue its own fiscal policies, unembarrassed by the Constitution,

> if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.

California has clearly conferred substantial opportunities, protection and benefits on CCA and the tax should be sustained accordingly.

DATED: September 29, 1982.

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